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Management's Liability for Defamation in Proxy Statements

Morton L. Berg

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THE SECURITIES EXCHANGE ACT of 1934[1] specifically provides for a dual system of regulation over securities and persons by both state securities commissions and the SEC, provided that the state authority does not conflict with the Exchange Act or consequent rules and regulations.[2] However, there is no direction given in the Act or its rules as to whether federal pre-emption will be applied when a Commission rule attempts to abrogate the state's common law of defamation.

Such an enigma, involving conflicts between federal and state laws and policies, is presented by two of the proxy rules—Rules 14a-7 and 14a-8.[3]

Rule 14a-7 requires that upon written notice from any "security holder who is entitled to vote," [4] management, at the security holder's expense, may either promptly supply a reasonably current stock holders list to the security holder[5] or mail his proxy material to the other stockholders.[6]

Rule 14a-8(a) permits any security holder entitled to vote to submit at a meeting proposals to management if they do not apply to elections to office. Management must, with certain exceptions,[7] include such proposals in its proxy statement. If management opposes this proposal, it must also include, at the security holder's request, in management's proxy statement a security holder's supporting statement defending the proposal in not more than 100 words.[8] Management's reply to the supporting statement may be of any length.

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1 48 Stat. 881 (1934), as amended, 15 U.S.C. §§ 78a-jj (1958), as amended, 15 U.S.C. §§ 78c-s. (Supp. V, 1963), as amended, 78 Stat. 425 (1964), as amended, 78 Stat. 565 (1964).

2 Securities Exchange Act of 1934 § 28(a), 48 Stat. 903 (1934), 15 U.S.C. § 78bb(a) (1958).

3 17 C.F.R. § 240. 14a-7, 14a-8 (1964). As to the laws and practices applicable to proxies generally, see, 3 Oleck, Modern Corporation Law, c. 59 (1959, with 1965 suppl.).

4 Rule 14a-7.

5 Rule 14a-7 (c).

6 Rule 14(b) (1). Management's decision whether to supply the list or to mail the material is at management's option. Smith v. Republic Pictures Corporation, 144 N.Y.S.2d 142 (Sup.Ct. 1955).

7 Rule 14a-8(c) (1)-(5) sets out circumstances, internal in nature, under which management may omit security holder proposals and supporting statements from its proxy statement. See, 2 Loss, Securities Regulation 900-912 (2d ed. 1961); Bayne Caplin, Emerson and Latcham, Proxy Regulation and the Rule-Making Process: The 1954 Amendments, 40 Va. L. Rev. 387 (1954).

8 Rule 14a-8(b).

Both Rules 14a-7 and 14a-8 provide management with a basic dilemma. If management complies with their duties under these two rules, and the security holder's proxy material, proposal, or 100 word statement contains defamatory material, management and the issuer will become republisher of the defamatory words. It is not necessary that the defendant, in a defamation action, originate the words. He may be liable in tort for a republication of defamation published by someone else. All that is needed is that the republisher communicate the words to someone, excluding the Commission, other than the defamed plaintiff.[9]

Since in most instances there is strict liability for republishing defamatory material,[10] management is in the undesirable position of probably being held liable for defamation without any resort to self-help by censorship. This is due to the fact that the Commission has the last word as to whether management must mail, or include in its own proxy statement, security holder proxy material.[11] It is true, under Rule 14a-7, that management may choose to supply a stock holders list to the security holder in lieu of mailing the proxy material.[12] However, management would rarely choose this list alternative, since the supplying of it would put management in the tactical disadvantage of not being able to examine a security holder's proxy material before it is mailed.[13] It is also true, that management can avoid the inclusion of the security holder's 100 word statement in their proxy material by not opposing the proposal.[14]

To management, such a choice may be inconsistent with their fiduciary duties to the corporation. Management's possible vicarious liability is not controlled by the *de minimis* argument. Former SEC Chairman Armstrong, referring to character impugning through proxy literature

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[9] Caldwell v. Cromwell-Collier Publ. Co., 161 F. 2d 333 (5th Cir. 1947); 3 Restatement, Torts § 578.

[10] The tort basis of fault for a republisher of defamatory material, with few exceptions not applicable to this situation, is liability without fault, Cobbs v. Chicago Defender, 308 Ill. App. 55, 31 N.E. 2d 323 (1941).

It is conceivable, that the person defamed by the security holder's proxy material, proposal or 100 word supporting statement will be the corporation or a member of management. If this situation occurred, the management member would be suing the issuer and the issuer would be suing management and both would be suing the security holder.

[11] Rule 14a-8. Union Electric Co., 37 SEC 721 (1957), petition for review dismissed as moot, sub nom., Dyer v. SEC, 251 F. 2d 512 (8th Cir. 1958), *vacated,* 359 U.S. 499 (1959), *modified,* 361 U.S. 803 (1959), 287 F. 2d 773 (8th Cir. 1961).

Due to the fact that Rule 14a-8 does not apply to election contests, the probabilities of defamatory matter contained in the proposal or the 100 word supporting statement is reduced. However, Rule 14a-7 includes election contests within its purview. Election contest proxy material is likely to contain reputation-damaging words.

[12] *Supra,* note 8.

[13] 2 Loss, Securities Regulation 892 (2d ed. 1961).

[14] Rule 14a-8(b).

testified that "no aspect of a proxy contest presented a more difficult problem." [15]

The Commission has attempted to solve this management dilemma by providing in Rule 14a-7(b)(3), that if management chooses to mail stock holder proxy statements, "neither the management nor the issuer shall be responsible for such proxy statements. . . ." [16] If management opposes the proposal, and hence comes under a duty to include the 100 word security holder supporting statement in its proxy material, "neither the management nor the issuer shall be responsible for such statement." [17]

Since no court has interpreted the no responsibility clauses, it can not be stated with absolute certainty that they will be interpreted as a Commission attempt to provide management and the issuer with a defense to defamation actions.[18] However, since this no responsibility language appears in the Commission rules, the interpretation by the Commission should be a conclusive definition of its meaning.[19] The Commission has designated the no responsibility clause as an attempt to relieve management from liability and place the sole burden for published security holder defamatory material on the security holder.[20] In addition, if the SEC interpretation is not followed, the question of the management's and the issuer's federal privilege is not mooted. Since Rules 14a-7 and 14a-8 create a basic unfairness to management and the issuer,

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[15] 3 Stock Market Study, Hearings before Subcom. of Senate Com. on Banking & Currency, 84th Cong., 2d Sess. (1956) 1553-54. Chairman Armstrong, on page 1554 of the same hearing stated that two common schemes of character attack were currently in use: (1) the device of using artfully worded statements or questions which discredited by innuendo; and (2) statements appearing in the press and elsewhere used as reprints in proxy material.

[16] *Supra*, note 3.

[17] Rule 14a-8(b), last sentence. It should be noted at this point, possibly due to a drafting oversight, the "no responsibility" clause in Rule 14a-8(b), does not extend to the security holder's proposal, but only to the 100 word statement.

[18] It is possible that the Commission meant that management should have no criminal liability, or that management should have no responsibility if the SEC brought an injunction action against them because they complied with their Rules 14a-7 and 14a-8 duties and included in their proxy statement, or mailed, security holder material which violated Rule 14a-9.

[19] Courts will not substitute judgment as to the interpretation the SEC gives to a rule unless the Commission's interpretation is clearly erroneous. Dyer v. SEC, 290 F.2d 541 (8th Cir. 1961), SEC v. Assoc. G. & Electric Co., 99 F.2d 795 (2d Cir. 1938).

[20] Hearings before House Com. on Int. & For. Commerce on H.R. 1493, H.R. 1821 and H.R. 2019, 78th Cong., 1st Sess. (1943) 109-10, 182, 269-70; Armstrong, The SEC and Proxy Contests, 181 Com. & Fin. Chronicle 1053, Col. 1 (1955). The original idea for the no responsibility clauses came from the Trust Indenture Act of 1939 § 312(c), 53 Stat. 1164 (1939), 15 U.S.C. 77 LLL (c) (1958), Congress in § 312(c) provided immunity to indenture trustees when the trustee circulates bondholder proxy material to other bondholders, above House *hearings*, page 182.

The English Companies Act, has a provision similar to Rules 14a-7 and 14a-8. The company, on application to the court, may have removed, any defamatory matter contained in shareholder resolutions, Companies Act, 1948 § 140(S). There has been no court interpretation of this section through April 1965.

they may plead the penumbra doctrine in an attempt to infer federal pre-emption of state law.

The Commission's no responsibility language, contained in Rules 14a-7 and 14a-8, directly poses the question whether these rules, containing an attempt to abrogate a state law of defamation, are to be considered to have the force and effect of law so as to invoke the "Supremacy Clause" of Article VI, Section 2 of the Federal Constitution.

There are no cogent legislative or historical discussions which directly answer this question.[21] However, if it can be said the reasons for adopting Rules 14a-7 and 14a-8 serve a valid social purpose, and unless these proxy rules contain no responsibility clauses, the rules will be unfair to management as well as the issuer. Therefore, the first step toward federal pre-emption of the state law of defamation has been taken.

Before discussing the substantive law of federal pre-emption, an investigation into the Commission's manner of dealing with this defamation problem under existing proxy rules will shed some light as to the magnitude of this problem.

Commission Filing and Review Procedure

Under Rule 14a-6,[22] the security holder's proxy material is reviewed by the Commission Staff before it is submitted to management for mailing. Rule 14a-6 supplies filing requirements for the security holder's proxy material whereby preliminary and preliminary supplementary proxy material must be furnished to the Commission, for examination, prior to distribution.[23]

Under Rule 14a-8, management will be the first to review the proposal and supporting statement. Section (d) of the rule puts the onus on management, to bring alleged false and defamatory material contained therein to the Commission's attention before management files its own proxy statement under Rule 14a-6. Management opposition to Rule

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[21] Rule 14a-8, originally Rule X-14A-7, contained the no responsibility clause from its inception in 1942, Sec. Ex. Act Rel. 3347 (1942). Rule 14a-7, originally Rule LA 6 Sec. Ex. Act Rel. 378 (class A) (1935), did not adopt the no responsibility language until 1952, Sec. Ex. Act Rel. 4775 (1952).

There was no discussion of the no responsibility clauses in Rules 14a-7 and 14a-8 in any proxy release, which the writer searched. Releases searched were Sec. Ex. Act Releases, 378 (Class A) 1935, 2376 (1940), 3347 (1942), 3998 (1947) (proposed), 4037 (1947) adopted, 4114 (1948) (proposed), 4185 (1948) adopted, 4668 (1952) (proposed), 4775 (1952) (adopted), 4950 (1953) (proposed), 4979 (1953) (adopted), 5212 (1955) (proposed), 5276 (1956) (adopted); 29 F.R. 18386 (proposed) (1964), 7508 (1965) (proposed), 7512 (1965) (proposed), and 7566 (1965) (to be effective 7-1-65).

[22] 17 C.F.R. § 240. 14a-6 (1964).

[23] Rule 14a-6 (a), (b) and (c). Three copies of preliminary proxy material must be filed with the Commission at least 10 days prior to the definitive communication of the material. Three copies of preliminary supplementary proxy material must be filed with the Commission at least 2 days prior to the definitive communication of the material. Both the 10 day and 2 day periods may be accelerated for good cause.

14a-8 security holder material takes the form of a memorandum, supported by an opinion of counsel on the applicable law, as to the reasons why management feels such a deletion is proper.[24] This memorandum is submitted to the Commission. If management fails to notice objectionable material, the Commission (if it discovers defamatory material when it examines management's proxy statement containing Rule 14a-8 material under Rule 14a-6) presumably will allow management to oppose this at a later time. However, in the Note to Rule 14a-6 the Commission has served fair warning that their review of filed material may take longer than the time indicated in Rule 14a-6. It is stated that "the printing of definitive copies for distribution . . . should be deferred until the comments of the Commission's staff have been received and considered." [25]

Commission examination and review of security holder material, proposals and supporting statements, is directed to the Staff of the Division of Corporation Finance.[26] This review is on a case by case basis.[27] If the Staff suspects there is false and defamatory material, it will start informal proceedings in order to determine whether the material is true.[28] Letters of comment will be sent to the security holder requesting supporting data for questionable statements.[29] Copies of the letters of comment are also sent to management and are considered confidential matter.[30] If the security holder can not produce adequate supporting data to prove the truth of his statements, the Staff will make a determination of what action to take based on the information obtained.[31] If either management or the security holder do not agree with the Staff's position regarding inclusion or exclusion of the security holder material, they can either submit a written statement of their views to the Commission or they can request to be heard orally by the Commission. The Commission, however, has discretion as to whether to allow any informal review beyond the Staff level.[32]

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[24] Rule 14a-8(d). This procedure is based on, 17 C.F.R. § 202.5 (1964), which sets down the means whereby a person can bring violations of proxy rules to the Commission's attention.

The Commission will give great weight to this opinion of counsel, Hearings before House Com. on Int. & For. Commerce on H.R. 1493, H.R. 1821 and H.R. 2019, 78th Cong., 1st Sess. (1943) 118.

[25] Note to Rule 14a-6 since the note is worded as should, instead of in the mandatory sense, would a willful violation be a crime? Could the SEC seek an injunction for its violation?

[26] 17 C.F.R. § 202.3 (1964).

[27] Letter from Chief Counsel, Division of Corporation Finance, to the writer (March 5, 1965).

[28] Securities Exchange Act of 1934 § 21(a), 48 Stat. 881 (1934), as amended, 15 U.S.C. § 78U(a) (1958). See 17 C.F.R. § 202.5 (1964).

[29] Armstrong, The SEC and Proxy Contests, 181 Com. & Fin. Chronicle 1053, Col. 1 (1955).

[30] *Supra,* note 27.

[31] 17 C.F.R. § 202.3(a) & 4(a) (1964). Note, 69 Harv. L. Rev. 1462, 69 (1956).

[32] *Supra,* note 47.

Survey of Rule 14a-9

The Commission's review of Rules 14a-7 and 14a-8 proxy material is within the internal limitations of these rules and is subject to the further limitation imposed by Rule 14a-9.[33] Rule 14a-9 provides, in part, "No solicitation subject to this regulation [Regulation 14.—Solicitation of Proxies] shall . . . [contain] any statement which, at the time and in light of the circumstances under which it is made, is false or misleading with respect to any material fact. . . ." [34] The Note to Rule 14a-9 defines defamatory proxy material as that made without factual foundation.[35] This is an example of what *may* be considered by the Commission as being misleading.[36] Presumably, any false defamatory statement *will* be held to be misleading if it is made with respect to any material fact. The policy behind condemning misleading statements is based on the assumption that "our economy is best served only if shareholders have information which is adequate and accurate so that [voter] decisions may be intelligent." [37] Also, misleading statements respecting a material fact are more likely to sway shareholder votes than a misleading statement respecting opinions on trivial matters.[38] Since by definition, in Rule 14a-9, an untrue defamatory statement respecting a material fact is misleading, scienter does not appear to be an element.[39] Materiality and fact are still at issue, but the definitions of these words are so broadly construed by the courts that no real interpretive problem exists.[40] The crucial problem of Rule 14a-9 involves the Commission in

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[33] *Ibid.* See 17 C.F.R. § 240. 14a-9 (1964).

[34] Rule 14a-9 also states that: "No solicitation . . . shall be made by means . . . which omits to state any material fact necessary to make the statements . . . not false and misleading."

Rule 14a-9 requires that any proxy solicitation which has become false and misleading must be corrected in subsequent proxy solicitations. If management belatedly discovered it had communicated defamatory material through Rules 14a-7 and 14a-8, and plans further solicitations, they could be required by the SEC to retract these statements under Rule 14a-9, Armstrong, The SEC and Proxy Contests, 181 Com. & Fin. Chronicle 1032, Col. 5 (1955). However, although the retraction may work as a mitigation of damages, the defamatory statement will have been communicated, hence actionable.

[35] 17 C.F.R. § 240. 14a-9, Note (1964). This Note contains four examples laid down by the Commission as to what it regards as may be misleading depending on the particular facts and circumstances. See, 2 Loss, Securities Regulation, 921-923 (2d ed. 1961).

[36] Rule 14a-9, Note (b).

[37] 22 SEC Ann. Rep. 36 (1956).

[38] The statement must be one which could influence the shareholder's vote. See 2 Loss, Securities Regulation, 917 (2d ed. 1961).

[39] Since it is the security holder who creates the defamatory words, scienter on the part of management would not be involved, unless management knew, or had reason to know, the words were false and defamatory and did not report this fact to the SEC. In the defamation setting it does not matter if management was as innocent as a new born baby; if they circulate the defamatory material, they will be held responsible under the doctrine of strict liability, *supra*, note 10.

[40] An opinion based on inadequate supporting facts is a fact, Ypres Cadillac Mines, Ltd., 3 SEC 41 (1938). See 3 Loss, Securities Regulation, 1436-1438 (2d ed. 1961).

determining whether a potentially defamatory statement is or was factually true at the time, and in light of the circumstances as they exist or existed, when the statement was made. The burden, as in a common law defamation action,[41] is on the security holder (potential primary defendant) to support his language to the Staff or the Commission, if they so request.[42]

In most cases, falsity is relatively easy to determine.[43] There are borderline cases, however, where either the innuendo is cleverly worded or the security holder's supporting evidence suggests more than a scintilla of truth.[44] The Commission and the courts have made statements adopting two sets of standards as to the policy of allowing 'puffing' in proxy material.[45] The difficulty in applying one or the other standard is that the Commission is attempting to strike a balance among three policies contained in Rules 14a-7, 14a-8 and 14a-9; (1) inducing shareholder democracy,[46] (2) allowing inter-shareholder materials to be distributed, before the meeting, in order that the shareholders will have time to examine these materials, which should aid them in making a reasoned voting choice on proposals,[47] and (3) being fair to management.[48] The Commission cannot hope to exclude all false defamatory

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41 In England, defamation is controlled by statute, The English Defamation Act, 15 & 16 Geo. VI and 1 Eliz. II, c. 66, S. 4.

Truth is a universal defense to a defamation action which must be proved by the defendant, see Cook v. East Shore Newspapers, 327 Ill. App. 559, 64 N.E.2d 751 (1946).

A minority of states, by statutes or through the common law, require that truth, in order to be used as a defense, must have been spoken with good motives and justifiable ends. See cases collected in 1 Harper & James, The Law of Torts, 1956.

42 *Supra*, note 29.

43 *Supra*, note 29, at 1052, Col. 4.

44 *Supra*, note 15.

45 Judge Rifkind, in SEC v. Okin, 48 F.Supp. 928, 930 (S.D.N.Y. 1943), *aff'd.*, 137 F.2d 862 (2d Cir. 1943) stated the proxy rules, while they don't allow lying, do allow liberties with the whole truth. In accord with Judge Rifkind was the Chairman of the SEC, Armstrong, The SEC and Proxy Contests, 181 Com. & Fin. Chronicle 1032 (1955). Yet, Judge Clark, in SEC v. May, 229 F.2d 123, 124 (2d Cir. 1956) indicated that the proxy rules were not the same as political contests. He indicated contestants in proxy contests would not be able to throw misleading statements about. In accord with the Second Circuit was Chairman Armstrong, 3 Stock Market Study, Hearings before Subcom. of Senate Com. on Banking & Currency 84th Cong., 2d Sess. (1955) 1548.

This seeming dichotomy in wording is designated not too helpful as a "predictive mechanism," see 2 Loss, Securities Regulation, 920-921 (2d ed. 1961).

46 Emerson and Latcham, SEC Proxy Regulation: Steps Toward More Effective Stockholder Participation, 59 Yale L. J. 635, 642 (1950).

47 *Ibid.* Proxy material violates Rule 14a-9 only if it is misleading at the time at which it was made. Wouldn't the exclusion of security holder material which later turned out to be true be just as likely to cause shareholders to make an unreasoned choice as the inclusion of false and defamatory matter?

48 Hearings before House Com. on Int. & For. Commerce on H.R. 1493, H.R. 1821 and H.R. 2019, 78th Cong., 1st Sess. (1943) 271.

It would be extremely unfair to management to have the burden of proving as true, in the defamation action, statements which the security holder made, since they may have no information concerning the statement.

statements through their review process[49] or to render, on all occasions, completely correct opinions as to the truth of proxy statements.[50] With the advent of Sections 12(g) and 14(c)[51] of the Exchange Act, the Commission's burden in the truth policing of proxy material will greatly increase.[52] It appears that Rule 14a-9 is one of the proxy rules which the Commission wishes to amend as part of its tooling up program to deal with the addition of Section 12(g) companies to proxy regulation. The proposal to Rule 14a-9[53] would add, as clause 14a-9(b),[54] the long standing Commission policy that the Commission's examination of proxy material is not to be considered a Commission finding that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of proxy material.[55] Does the proposed addition to Rule 14a-9 imply that the Commission recognizes that the '12(g) companies' will so increase their work load that their previously excellent scope of review will be hampered?

Is Rule 14a-9 Extra Legal?

There have been attacks against the constitutionality of SEC Rule 14a-9 procedures. The critics contend that the Commission is a censor and violates the First Amendment in attempting to regulate, through a fraud rule, the content of proxy material.[56] In the case of *SEC v. May*,[57] the court summarily dismissed this contention. The Commission maintains that it does not censor or delete but merely reviews statements in proxy material. It contends that only the federal courts have

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[49] It has been strongly suggested that the SEC scrutiny of proxy solicitation material is inadequate, Williams, Cumulative Voting for Directors 71 (1957). "Time does not permit an independent examination of the facts set out in the proxy material and this results in the Commission accepting the representations . . . at their face value," J. I. Case Co. v. Borak, 377 U.S. 426, 432 (1964).

[50] "The Commission's scrutiny of proxy material does tend to prevent the use of misleading facts or to correct them, but it cannot guarantee such results, Armstrong, The SEC and Proxy Contests, 181 Com. & Fin. Chronicle 1052, Col. 4 (1955).

But see, "The SEC has been reluctant, as a matter of policy, to initiate litigation during a proxy fight because the injured party may reply, or seek his own legal remedy," 3 Stock Market Studies, Hearings before Senate Com. on Banking & Currency, 84th Cong., 1st Sess. (1955) 155.

[51] Securities Exchange Act of 1934, as amended, 78 Stat. 569 (1964). It will be of almost no advantage for a company not to solicit proxies, since under § 14(c), the company must supply equivalent information, based on the proxy rules, to the SEC even if it does not solicit.

[52] It is estimated that Section 12(g) of the Exchange Act will subject, under the 500 shareholder equity test, 3900 previously unregulated and 15(d) companies to the proxy rules, Investor Protection, Hearings before Subcom. of House Com. on Int. & For. Commerce on H.R. 6789, H.R. 6793, and S. 1642, 88th Cong., 1st Sess., Part 1 (1963) 161.

[53] 29 F.R. 18386 (1964); Sec. Ex. Act Rel. 7481 (1964).

[54] The new clause, if adopted, would be 17 C.F.R. § 240. 14a-9(b).

[55] 29 F.R. at 18387 (1964).

[56] SEC v. May, 229 F.2d 123, 124 (2d Cir. 1956).

[57] *Id.*

the power to censor.[58] However, since the Commission is able to relieve management of its duties under Rules 14a-7 and 14a-8, it does have a powerful ability to censor.[59] Also, Mr. Justice Black held that Congress may, without violating the First Amendment, legislate under the commerce power to protect the use of the mails from swindles.[60] The test used to determine whether legislation violates the First Amendment is whether the harm is greater than the value of the words.[61] Since one rationale behind Rule 14a-9 is to keep material which will prevent the security holders from making a reasoned choice out of their reach, it would seem that the First Amendment should not protect fraud in the proxy setting. This assumes the Commission is not using its fraud rule to censor for censorship sake. Also, the Commission fathered the proxy rules and should be able to restrict them unless these restrictions destroy the policies Congress wished to protect.[62] However, when the Commission enjoins false defamatory matter under Rule 14a-9 by not requiring management to conform to their Rules 14a-7 and 14a-8 duties, the Commission not only enjoins false material but also enjoins defamatory material.

The power of equity to enjoin misleading matter in the securities field was first recognized in England in the late nineteenth century.[63] Equity courts advance three primary reasons for their reluctance to enjoin defamation.

First, equity has jurisdiction only to protect property rights, not personal rights.[64] Defamation, except for business defamation, is not an injury to property rights but an injury to reputation, which is a personal right.[65] This distinction has been severely criticized as not protecting reputation, which by its nature can never be adequately protected by

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[58] *Supra,* note 43.

[59] See Union Electric Co., 37 SEC 721 (1957), petition for review dismissed as moot, sub. nom., Dyer v. SEC, 251 F.2d 512 (8th Cir. 1958), *vacated,* 359 U.S. 499 (1959), *modified,* 361 U.S. 803 (1959), 287 F.2d 773 (8th Cir. 1961).

[60] Donaldson v. Read Magazine, 333 U.S. 178, 190-91 (1947). Mr. Justice Black is known for his strong position favoring the First Amendment, yet when fraud is involved he allows suppression of speech.

[61] Note, *9 Harv. L. Rev. 1462, 1473 (1956).

[62] Does the power to create imply the power to limit? It would seem so, especially where what is created is a privilege such as Rules 14a-7 and 14a-8. Dyer v. SEC, 290 F.2d 541 (8th Cir. 1961).

One of the policies of Congress in passing proxy legislation was to "control the conditions under which proxies may be solicited with a view to preventing recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders," House Comm. on Int. & For. Commerce, H. Rep. No. 1383, 73d Cong., 2d Sess. (1934) 14.

[63] The "tricky circular" cases, see Kaye v. Craydon Framways Co. [1898], 1 Ch. 358 (C.A.).

[64] Long, Equitable Jurisdiction to Protect Personal Rights, 33 Yale L. J. 115 (1923); Gee v. Pritchard, 2 Swans. 402, 36 Eng. Rep. 670 (Ch. 1818).

[65] Pound, Equitable Relief Against Defamation and Injuries to Personality, 29 Harv. L. Rev. 640 (1916).

legal remedies.[66] Also, courts allow the enjoining of torts, such as the right of privacy, which may also be based on defamatory language.[67]

The second objection to enjoining defamation is that to do so would violate the First Amendment.[68] The Commission, when it allows management to delete security holder proxy material, proposals or 100 word statements, in effect enjoins defamation of particularly worded phrases and not prospective defamation. Although injunctions against prospective defamation tend to be directed toward the total silencing of future speech,[69] an injunction against specific defamatory wording, already in existence, would be no more objectionable as a restriction of free speech than defamation sanctions of punitive damages and criminal libel.[70] The Commission is not inhibiting speech in a general sense, but is attempting to delete specific wording, already communicated by the security holder, which has been adjudged to be beyond the range of constitutional protection.[71]

The third argument against enjoining defamation is that juries are thought to have special competence in deciding issues of falsity.[72] However, if the security holder disagrees with the Commission's opinion, he may begin a private action against management to compel them to perform their functions under Rules 14a-7 and 14a-8.[73] A court would make the final decision as to falsity, and could impanel a jury to decide the issue of truth.[74]

Moreover, the Commission's policy in enforcing Rule 14a-9, is to prevent fraud and not to enjoin defamation.[75] The Commission created

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[66] Note, 69 Harv. L. Rev. 875, 943 (1956).

[67] Gee v. Pritchard, *supra,* note 64.

[68] Marlin Fire Arms Co. v. Shields, 171 N.Y. 384, 64 N.E. 163 (1902).

[69] Near v. Minnesota ex rel. Olson, 283 U. S. 697 (1931), held that enjoining all future speech of a newspaper because of past defamatory statements violated the First Amendment.

The *Near* Court held that describing an injunction of defamation as a public nuisance would not have the constitutionality of the defamation statute. On this reasoning, the Commission's argument that it was only under Rule 14a-9, enjoining misleading statements whether or not defamatory would fail. However, *Near* involved an injunction against unknown future defamatory words and not an exact set of words.

Also, the Commission regulation of false and defamatory material is required for the public interest and should not be frustrated by ancient equity dogma.

[70] Note, 49 Colum. L. Rev. 1001 (1949). See, Chafee, Free Speech in the United States 9 (1954).

[71] Beauharnais v. Illinois, 343 U.S. 250 (1952).

[72] *Supra,* note 65, at 655-56.

[73] J. I. Case Co. v. Borak, 377 U.S. 426 (1964).

[74] An equity judge may, under single action statutes, allow a jury to determine questions of law, Pugh v. Tidewell, 52 N.M. 386, 199 P.2d 1001 (1948). The Federal Courts have adopted the merger of law and equity into a single action statute, Rules of Civil Procedure for United States District Courts, 28 U.S.C. (appendix, Rule 2) (1958).

[75] "Commission proxy rules . . . are designed to assure that basic facts are disclosed but leave a wide area for fair comment," Armstrong, The SEC and Proxy Contests, 181 Com. & Fin. Chronicle 40, Col. 1 (1955).

Rules 14a-7 and 14-8 to protect 'shareholder democracy' through increased emphasis on shareholder voting, based on accurate information, and intra-shareholder communication. Allowing false, defamatory material to be included in proxy statements would be tantamount to using Rules 14a-7 and 14a-8 as shields for fraud.[76]

There has been some suggestion that, as a solution, the Commission should deal with fraud problems by allowing the private sanction of reply.[77] This proposed private sanction could quickly lead to accelerated chaos and completely frustrate Commission policies favoring accurate shareholder information. Also, management may have no access to materials which would disprove false security holder statements.

Enforcement of Rules 14a-7, 14a-8 and 14a-9

Except for the power of suggestion, the Commission in an ordinary proxy solicitation case has no sanctions it can impose to enforce Rule 14a-9.[78] The sanctions are normally imposed by United States district courts through injunctions applied for by the Commission.[79] However, if the Commission decides that security holder proxy material, proposals or 100 word statements contain false and defamatory statements, it has a most effective remedy. The Commission will not require that management comply with their Rules 14a-7 and 14a-8 duties.[80] If it determines that security holder material submitted under Rules 14a-7 and 14a-8 does not violate Rule 14a-9, the Commission will request management to comply with their duties under Rules 14a-7 and 14a-8.[81] Though not

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[76] Assume that the security holder's proxy material, proposal or 100 word supporting statement is false and defamatory. If management has another defense available to it, should the Commission require management to comply with their Rules 14a-7 and 14a-8 duties? Not only would this procedure frustrate the Commission's accurate proxy material policy but it would involve the Commission in playing the role of a state court judge on a subject in which it is not expertise.

[77] This solution was dismissed as not propitious, SEC v. May, *supra,* note 56. But see, statement in legislative hearings, footnote 50, *supra.*

[78] *Supra,* note 43.

[79] Securities Exchange Act of 1934 §§ 21 (e) and (f), 15 U.S.C. §§ 78 u (e) and (f).

[80] Dyer v. S.E.C., 290 F.2d 541 (8th Cir. 1961). See footnote 11 *supra.* Sec. Ex. Act Rel. 3638 (1944).

[81] Union Electric Co., 38 SEC 240 (1958), Dyer v. SEC, 266 F.2d 33 (8th Cir. 1959), *cert. denied,* 361 U.S. 835 (1959), *rehearing denied,* 361 U.S. 911 (1959).

As a condition precedent to the private action, the security holder should exhaust his administrative remedies. This procedure would, at least, involve discussion with the Staff and a request to be heard by the Commission, Peck v. Greyhound, 97 F.Supp. 679 (D.C.S.D. N.Y. 1951).

If the Commission remained silent, and paid no attention to the security holder's requests to force management to comply with their Rules 14a-7 and 14a-8 duties, this silence should have no effect on the court's decision. However, as Professor Loss points out, courts have used Commission silence as a basis of decision when they felt disposed to rule in a particular way, 2 Loss, Securities Regulation 953 (2d ed. 1961); Dunn v. Decca Records, Inc., 120 F.Supp. 1 (D.C.S.D.N.Y. 1954). See footnote 73 *supra.*

Management, if requested to comply with their Rules 14a-7 and 14a-8 duties by

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likely to do so because of pressures and the fear of bad publicity, management may disagree with the Commission and refuse to comply with the Commission's request. Management may then solicit, or threaten to solicit, their own proxy material, ignoring their duties under Rules 14a-7 and 14a-8.

The Commission, in order to enforce a threatened violation of Rules 14a-7 and 14a-8, may seek a mandatory injunction in a United States district court to force management compliance.[82] If management has begun its solicitation of proxy material, the Commission may seek an injunction to prevent management from further solicitation and from using proxies already obtained.[83]

Management's defense to an injunction action would be to allege the security holder's proxy material, proposal or 100 word statement violated Rule 14a-9 because it was false and defamatory. The court would not reverse the Commission unless management could show that the Commission's action was based on facts so prejudicial to management as to be considered a gross abuse of discretion. Courts have frequently stated that the SEC should be the interpreter of their own rules and policies, unless judicial interference is absolutely necessary.[84] Although the court could decide whether the 'no responsibility' clauses of Rules 14a-7 and 14a-8 provide management with a federal privilege to a state defamation action, it would, in all probability, not do so since courts are reluctant to construe the Federal Constitution in deciding a case, unless absolutely necessary.[85]

Private Action

If the Commission relieved management of their duties under Rules 14a-7 and 14a-8 or refused to institute injunction proceedings for threatened or actual management proxy solicitation, the security holder could begin a private injunction against management, alleging a violation of Rule 14a-7 and 14a-8.[86] There would be no written record of the Com-

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the Commission may also under the authority of 'Borak' begin a private action against the security holder for injunction alleging a violation of Rule 14a-9. Management's chances would be slim for the reasons announced on page 22 *infra*. For an excellent discussion of the pre-'Borak' law of private actions under the proxy rules, see, 2 Loss, Securities Regulation 932-973 (2d ed. 1961).

[82] Securities Exchange Act of 1934 § 21 (f); SEC v. Transamerica Corp., 67 F.Supp. 326, 334 (D. Del. 1946), modified and aff'd. on another issue, 163 F.2d 511 (3rd Cir. 1947), *cert. denied*, 332 U.S. 847 (1948); Henwood v. SEC, 298 F.2d 641 (9th Cir. 1962).

[83] Securities Exchange Act of 1934 § 21 (e). *Supra*, note 82.

[84] SEC v. Assoc. G. & Electric Co., 99 F.2d 795 (2d Cir. 1938).

[85] Ashwander v. TVA, 297 U.S. 288 (1936).

[86] *Supra*, note 73. Private actions based on the proxy rules serve as an "effective weapon in the enforcement of the proxy requirements," *supra* at 432 as in any injunction action, the private party must show clear and convincing evidence, Kauder v. United Board Corp., 199 F.Supp. 420 (S.D.N.Y. 1961).

mission's informal proceedings and comments to security holders or management. The court could, however obtain reasons for the Commission's refusal to force management to comply with their duties under Rules 14a-7 and 14a-8 by either a reported statement of a Staff member, an SEC memorandum or an SEC brief amicus curiae.[87] If the Commission flatly refused to request that management comply with Rules 14a-7 and 14a-8, the security holder has little hope for a court victory.[88] The court would defer to the Commission's interpretation of the rules—absent a gross abuse of discretion—and point out that the security holder only has a privilege under Rules 14a-7 and 14a-8.[89] The court could also rely on the fact that the proxy rules, especially Rules 14a-7 and 14a-8, were instituted by the Commission to promote the security holder's ability to obtain or provide information necessary for 'corporate democracy.' The court should not assume, without the strongest proof, that the Commission is not carrying out its own policies of advancing security holder's disclosure privileges.

Judicial Review of Commission Action

Section 25(a) of the Exchange Act provides for judicial review, in a United States Court of Appeals, for any one adversely affected by a commission order, but only if the order was obtained "in a proceeding to which such person . . . [was] a party. . . ." [90]

The SEC is subject to the Administrative Procedure Act's[91] (APA) judicial review section,[92] insofar as Section 25(a) of the Exchange Act does not preclude the APA from operating. However, by its wording, the judicial review section of the APA does not apply to Commission

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[87] Note, 69 Harv. L. Rev., 1462, 1471 n. 52 (1956). But cf., Peck v. Greyhound, 97 F.Supp. 679 (D.C.S.D.N.Y. 1951), where the court implied it could not review without an agency record.

[88] This event occurred in Union Electric Co., 38 SEC 240 (1958), Dyer v. SEC, 266 F.2d 33 (8th Cir., 1959), *cert. denied,* 361 U.S. 835 (1959), *rehearing denied,* 361 U.S. 911 (1959).

[89] See, SEC v. Assoc. G. & Electric Co., 99 F.2d 795 (2d Cir. 1938), on the discretion point; and Dyer v. SEC, 290 F.2d 541 (8th Cir. 1961) on the privilege point.

[90] 48 Stat. 901 (1934), as amended, 15 U.S.C. § 78y(a) p. 401 (1958).

[91] 60 Stat. 237 (1946), as amended, 5 U.S.C. §§ 1001-1011 (1958).

[92] Administrative Procedure Act § 10, 60 Stat. 243 (1946), as amended, 5 U.S.C. § 1009 (1958).

The APA, in § 2(d), 5 U.S.C. § 1001(d), defines order as, "the whole or any part of the final disposition (whether affirmative, negative . . . in form) of any agency in any matter other than rule making. . . ." One issue under § 25 of the Exchange Act is whether the Staff or Commission make an order when they informally deal with Rules 14a-7, 14a-8, and 14a-9. Although pre-APA law seemed to indicate informal decrees of the Commission were not orders, Crooker v. SEC, 161 F.2d 944 (1st Cir. 1947), the APA definition of order is now broadly worded, and the law now seems to be that lack of a formal order will not bar review, Phillips v. SEC, 171 F.2d 180 (2nd Cir. 1948).

APA § 2(g), defines agency proceeding as any agency process including the order process contained in APA § 2(d).

determinations under Rules 14a-7, 14a-8 and 14a-9, unless the Commission permits management or the security holder to be a party.[93]

Management or the security holder may disagree with the Staff's interpretation of the Rules and request to be heard by the Commission. The Commission at its discretion can either deny this request and uphold the Staff without further hearing, or grant the request and render its own opinion.

There is no judicial review open to either party where: (1) the Commission upholds the Staff with or without further proceedings or (2) reverses the Staff, unless it can be shown the Commission's interpretation of its own rules is clearly erroneous.[94] The technical reason for lack of judicial review is that neither management nor the security holder are parties, as required under Section 25(a).[95] The more cogent reason is that if a court substituted its judgment for Commission's interpretations of proxy rules, it would be nullifying a discretionary interpretation of the Commission's own rules, presumably made only after full consideration.[96]

Joining the Issues

Management's chances of obtaining relief through court action, from a Commission determination that management must comply with Rules

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[93] The SEC's review proceedings, both at the Staff and Commission level, are by law committed to agency discretion, Securities Exchange Act of 1934 § 21(a), 48 Stat. 899 (1934), as amended, 15 U.S.C. § 78U(a) (1958): See, 17 C.F.R. § 202.5 (1964).

APA § 10, the judicial review section, *id.*, does not apply where, "agency action is by law committed to agency discretion." The discretionary nature of the SEC's review procedure of Rules 14a-7, 14a-8 and 14a-9 proxy material removes it from APA § 10, Leighton v. SEC, 221 F.2d 91 (D.C. Cir. 1955), *cert. denied*, 350 U.S. 825 (1955), *rehearing denied*, 350 U.S. 905 (1955). However, APA § 10(c) states that every agency action for which there is no other adequate remedy in any court shall be subject to judicial review." Professor Davis, in Davis, Nonreviewable Administrative Action, 96 U. of Pa. L. Rev. 749 (1948), believes, due to the hardships involved of not having any judicial review of discretionary agency action, that APA § 10(c) limits APA § 10 to a case where there is an adequate court remedy available to the person seeking review. Both management and the security holder do have a private action based on proxy rule violations, J. I. Case Co. v. Borak, 377 U.S. 426 (1964), hence are not totally being denied judicial review of Commission action.

[94] Curtin v. American Tel. & Tel. Co., CCH Fed. Sec. L. Rep. ¶ 90659 (civil 91-381, S.D.N.Y. 1954). Of course, when the reviewing court hears the case as to abuse of discretion there is a limited form of judicial review.

[95] Party is defined, in APA § 2(c), as a person who is allowed to be a party by an agency or entitled as of right to be a party. The Commission does not allow either management or the security holder to be admitted as a party under their procedures of reviewing proxy material, letter of Dir., Div. of Corp. Fin. CCH Fed. Sec. L. Rep. ¶ 90659. Neither management nor the security holder is entitled as of right to be a party, Peck v. SEC (C.A.2d, Docket 22, 289, 1952), since to deny him party status does not violate due process, Dyer v. SEC, 290 F.2d 541, 8th Cir. 1961).

The judicial review section of the Public Utility Holding Company Act of 1935, § 24(a), 49 Stat. 834 (1934), as amended, 15 U.S.C. § 79x(a) (1958) does not contain the party provision. Yet, a Commission refusal to a shareholder's request for a hearing concerning proxy Rule 14a-8 was not subject to judicial review since all that was involved were privileges granted by the Commission, Dyer v. SEC, *supra* at 547.

[96] Weeks v. Alpert, 131 F.Supp. 608 (D. Mass. 1955).

14a-7 and 14a-8, are almost nonexistent. Because of the time element involved in any proxy situation, management would most likely accept a Commission ruling and publish security holder material via Rules 14a-7 and 14a-8. If sued for defamation in a state court, a Commission, or a federal court ruling that the security holder's material was true would not bind the state court on the truth issue, under the doctrines of collateral estoppel or res judicata.[97]

Section 23(a)[98] of the Exchange Act provides immunity for good faith reliance on a Commission rule, but this section only applies where a *provision* of the Exchange Act or *rules* thereunder imposes liability. Section 23(a) says nothing about the situation where the liability is imposed by state common law.

Even if management can show this good faith reliance on the 'no responsibility' clauses of Rules 14a-7 and 14a-8, § 23(a) will provide no defense to a state defamation action.[99]

Section 27[100] of the Exchange Act would not provide a bar to a person bringing a state court defamation action since the alleged wrong depends on state law and not on a violation of the Exchange Act or Commission rule.[101]

The defense of management or the issuer to the state defamation action would be that the 'no responsibility' clauses in Rules 14a-7 and 14a-8 pre-empts the state law of defamation in this narrow area.

The remaining sections of this study will be directed to the substantive law of federal pre-emption and other federal and state defenses which may be available to management and the issuer against defamation.

Federal Pre-emption

A state's common law rule must yield to a constitutional statute of Congress.[102] A regulation of an administrative agency, made in pursuance to a constitutional grant of power by Congress, has the same force of law as a statute enacted by the Congress.[103]

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97 See 2 Loss, Securities Regulation 1015-1019 (2d ed. 1961). The parties would not be the same in the state defamation action.

98 48 Stat. 901 (1934), as amended, 15 U.S.C. § 78w(a).

99 For examples of how § 23(a) was used in connection with Rule 16b-3, see, 3 Loss, Securities Regulation 1842-1849 (2d ed. 1961).

100 Provides that the federal courts are to have exclusive jurisdiction of the violations of the Exchange Act or its rules, 48 Stat. 902 (1934), as amended, 15 U.S.C. § 78aa.

101 American Well Works Co. v. Lane & Bowler Co., 241 U.S. 257 (1916), Pan Am. Corp. v. Superior Court, 366 U.S. 656, 662 (1961).

The SEC could not enjoin the defamed plaintiff from bringing a state defamation action, but could file a brief amicus on behalf of the management and/or the issuer.

102 See, Sola Electric Co. v. Jefferson Electric Co., 317 U.S. 173 (1942).

103 See, A. T. & S. F. Ry. v. Scarlett, 300 U.S. 471 (1937), *rehearing denied*, 301 U.S. 712 (1937).

The application of these two doctrines provides one basis of solution to the problem of management's 'damned if we do, damned if we don't' position in relation to Rules 14a-7 and 14a-8.

Invoking federal pre-emption as a solution depends on whether Congress is able to constitutionally abrogate state defamation laws if Rules 14a-7 and 14a-8 were Acts of Congress. If so, what limitations are placed on the Commission in attempting to do by rule what Congress can do by statute?

Constitutional Limitations on Congress

The constitutional basis for the Securities and Exchange Act of 1934 is found in the commerce power of Congress.[104]

Decisions of the United States Supreme Court, since 1942, have made it clear that the commerce power is no longer interpreted by determining whether proscribed activities are commerce or interstate in nature.[105]

The current test of pre-emption will be invoked if the activity abrogated by Congress bears a close relation to interstate commerce so that its regulation is necessary to protect the *policy*[106] announced by the legislation.[107]

Valid Congressional legislation under the commerce power has been universally held to pre-empt conflicting state law.[108] The limitation placed on Congressional Commerce power is the Due Process Clause of the Fifth Amendment,[109] and the Tenth Amendment will offer no sanctuary to the states.[110]

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[104] Securities Exchange Act of 1934 §§ 2, 2(1), 2(3), 48 Stat. 881 (1934), as amended, 15 U.S.C. §§ 78b, 78b(1), 78b(3) (1958). In Mr. Justice Black's opinion the Exchange Act was passed by Congress, under the commerce power to protect against fraud. Donaldson v. Read Magazine, 333 U.S. 178, 190-91 (1947).

[105] For an excellent history of the trials and tribulations of the "Commerce Clause" see, Stern, The Commerce Clause and the National Economy, 1933-46, 59 Harv. L. Rev. 645, 883 (1946). Professor Landis of Harvard Law School in 1932 thought regulation of exchanges would not be based on the commerce power, Hearings before Committee on Int. & For. Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. (1934) 237-238, 246-251. See, Wickard v. Filburn, 317 U.S. 111 (1942).

For a comprehensive presentation of the unorthodox thesis that the commerce clause, if its meaning were correctly interpreted, empowers Congress to govern all gainful activity throughout the country, and that the phrase "among the several states" was never intended to have the meaning "interstate," see, Crosskey, Politics and the Constitution in the History of the United States (2 Vols. 1953).

[106] The legislative policy for proxy rule regulation under the Exchange Act was to obtain: "power to control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of shareholders," H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934) 13-14.

[107] Carpenter and Mardian, What is Commerce?, 22 So. Cal. L. Rev. 398 (1948). See, Wickard v. Filburn, 317 U.S. Ill. (1942).

[108] See, Gibbons v. Ogden, 9 Wheat. 1 (1824), which is the leading case on the commerce power.

[109] See, Carolene Products Co. v. U.S., 323 U.S. 18 (1944). The commerce power has been described, "as broad as the economic needs of the nation," American Power & Light Co. v. SEC, 329 U.S. 90, 104 (1946).

[110] U.S. v. Darby, 312 U.S. 100, 123-124 (1941).

The United States Supreme Court has held, in *Farmers Union v. W. Day,*[111] that Congress may, under the commerce power, and through the Supremacy Clause, abrogate the state law of defamation.

Farmers Union involved an interpretation of Section 315 of the Federal Communications Act which provides that a radio or television station must give equal time to any legally qualified political candidate without prior censorship, if the station previously allowed air time to any one candidate for the same political office.[112]

The defamation suit against the station, arose as a result of a political speech pursuant to a request for equal time, in which the candidate defamed the plaintiff. The entire court held that Section 315 of the Federal Communications Act gave the station no right to censor political speech.[113] Rules 14a-7 and 14a-8 do not give management the right to censor security holder proxy material. Commission policy, in Rule 14a-8, determined it would be desirable for management to point out possible 14a-9 violations as an adjunct to the Commission's policing of fraud. Yet, the Commission, not management has the final say as to exclusion. The unfairness is as inherent to management as it was to the stations in the *Farmers Union* case. The majority of the *Farmers Union* Court felt that station censorship would frustrate the purpose of the Communications Act favoring full discussion of political views—since "all remarks even faintly objectionable would be excluded out of an excess of caution."[114] Rigorous policing of its fraud rule would negate the Commission's reason for enacting Rules 14a-7 and 14a-8; which favor full discussion of corporate views involved in corporate elections and meetings.

The majority of the *Farmers Union* Court further held that if state law was not abrogated, its enforcement would either stand as an obstacle to the purposes of Congress or would impose unreasonable and unfair burdens on radio stations. The majority would not assume that Congress wanted to be unfair unless it specifically stated so. This result was reached even though the majority admitted that Congress may not have intended such an immunity.[115] The basis of the courts reasoning points to the fact that the FCC, in announcing its *Port Huron* doctrine, interpreted Section 315 as granting an immunity.[116] Congress, after the

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[111] 360 U.S. 525 (1959). This case involved a 5 to 4 decision.

[112] 48 Stat. 1088 (1934), as amended, 47 U.S.C. 315(a) (1958). There was no station censorship of this broadcast, *id.* at 526.

[113] *Supra,* note 111 at 535.

[114] *Supra,* note 111 at 530.

[115] *Supra,* note 111.

[116] A short history of the pre and post Port Huron doctrine will illustrate the need for uniformity.
Section 29 of the Radio Act of 1927, 44 Stat. 1172 (1927) contained the same
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announcement and with the knowledge of the *Port Huron* doctrine amended Section 315 without departing from the FCC's view.[117] The Congress, also with knowledge, of the Commission's 'no responsibility' policy amended Section 14 of the Exchange Act in 1964 without departing from the SEC's view. The majority of the Court dismissed the argument that a station could protect itself from defamation liability by denying all political candidates air time as being contrary to the purposes of Section 315.[118] Management could protect itself from liability for defamation by never soliciting its own proxies—a practice which would be contrary to the disclosure principles embodied in the proxy rules and inconsistent with § 14(c).

The holding in the *Farmers Union* case is an example of the 'penumbra' doctrine of interpreting commerce clause legislation. The Supreme Court inferred federal pre-emption of state law because the legislation presented an internal dichotomy of announcing a national regulatory policy which was unfair to the regulated industry.

The majority could not and did not say that the FCC's *Port Huron* doctrine had the force and effect of law.[119] The *Port Huron* doctrine was an interpretation of Congressional legislation, in effect, a constitutional decision which can not bind the Supreme Court. The differences between what the FCC did in *Port Huron* and what the Commission is trying to do in the 'no responsibility' clauses of Rules 14a-7 and 14a-8 may be found in the Congressional enabling acts. Section 315 of the Communications Act in and of itself makes the policy decision without

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no censorship, equal time provisions as § 315 of the Federal Communications Act does. Sorensen v. Wood, 123 Neb. 348, 243 N.W. 82 (1932), appeal dismissed sub. nom. KFAB Broadcasting Co. v. Sorensen, 290 U.S. 599 (1933) involved, for practical purposes, the same facts as in Farmers Union. The State Court held that Congress did not intend a federal privilege because it would raise a question of the Fifth Amendment. The radio station was held strictly liable for the defamation. *In accord* with Sorensen was Josephson v. Knickerbocker Broadcasting Co., Inc., 179 Misc. 787, 38 N.Y.S.2d 985 (Sup. Ct. 1942).

The FCC in Port Huron Broadcasting, 12 FCC 1069 (1948), stated, via dicta, that Section 315 did give a federal privilege. The determination, in Port Huron, was made in a license renewal hearing in which the station had censored some political material. The FCC preached that the station should not censor, it had a federal privilege. The station's license was renewed after the wrist slapping.

The resistance to Port Huron was fierce. The Texas Attorney General, in Broadcasting, July 5, 1948, P. 50, Col. 4, stated Texas would not follow Port Huron. Houston Post Co. v. U. S., 79 F.Supp. 199 (S.D. Tex. 1948) stated via dicta that the FCC exceeded their authority in announcing the Port Huron doctrine. Daniel v. Voice of N. H., Inc., 10 Pike & Fisher Radio Reg. 2045 (N.H. Sup. Ct. 1954) also, via dicta, stated that the FCC was wrong in Port Huron.

However, all was not lost to the FCC for a few state courts agreed with Port Huron and held that Section 315 created a qualified federal privilege, see Charles Parker Co. v. Silver City Crystal Co., 142 Conn. 605, 116 A.2d 440 (1955).

[117] In other words, Congress re-enacted the section knowing full well what their own legislative agency thought of the problem. The Court then used Port Huron as legislative history.

[118] *Supra,* note 111.

[119] *Id.*

granting an immunity for defamation.[120] Section 14 of the Exchange Act leaves the proxy policy determinations to the Commission under a broad grant of rule-making power.[121]

If the Commission's 'no responsibility' language in Rules 14a-7 and 14a-8 has the force and effect of law, there is a stronger argument for federal pre-emption in the proxy context than in the Communications Act context, since the 'penumbra' doctrine, or inferring legislative desires, will not be needed to solve the problem.

Delegation of Congressional Authority

In determining whether a Commission rule may invoke federal pre-emption of a state's common law, the constitutional doctrines of delegation and adequate standards must be examined.

"Congress may and lawfully does delegate legislative power to administrative agencies. Delegation by Congress to agencies has long been recognized as necessary in order that the exertion of legislative power does not become a futility." [122]

However, Congress may not delegate any part of its legislative power to agencies without prescribing a standard.[123] The theory of the standard requirement is that Congress must declare a policy with respect to a subject so that the agency will not act outside its scope of authority.

The standard set down by Congress in the proxy rule area is contained in Section 14 of the Exchange Act. "[T]he Commission may prescribe [such proxy rules and regulations] as necessary or appropriate in the public interest or for the protection of investors. . . ." [124]

The United States Supreme Court has upheld the 'public interest' as a valid and adequate Congressional standard.[125]

In *SEC v. May* the court stated that "the Commission's proxy rules as applied either to management or insurgent stockholder groups are clearly authorized by statute." [126]

Far from being a brief grant of authority, Section 14 has been interpreted as giving the Commission a carte blanche power with respect to experimentation in the proxy field. One Federal Court has

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[120] Section 315, in 1959, read: "(a) If any licensee shall permit any person who is a . . . candidate for any public office to use a . . . station, he shall afford equal opportunities to all . . . other candidiates . . .: Provided, . . . the licensee shall have no power of censorship. . . ."

[121] Securities Exchange Act of 1934 § 14, 48 Stat. 895 (1934), as amended, 15 U.S.C. § 78 n, as amended, 78 Stat. 569 (1964).

[122] Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 398 (1940). See, 1 Davis, Administrative Law Treatise §§ 2.01-2.16 (1958).

[123] U.S. v. Chicago M. St. P. & P. R. Co., 282 U.S. 311, 324 (1931).

[124] Securities Exchange Act of 1934 § 14(a) and (b).

[125] New York Central Securities Corp. v. U.S., 287 U.S. 12 (1932).

[126] *Supra*, note 56 at 124.

designated the Section 14 language: "as the Commission deems necessary or appropriate" [127] as the conferring by Congress on the Commission, "legally the broadest content of regulatory and administrative power possible." [128] The same Court has found Commission power, under the proxy rules, to be determined by its own judgment as to need and appropriateness, and not in statutory specification.[129]

Professor Davis states:

> Sometimes telling the agency to do what is in the public interest is the practical equivalent of instructing it: Here is the problem. Deal with it.[130]

Rules 14a-7 and 14a-8—Legislative or Interpretive

A major factor in determining whether the Commission's no responsibility language has the force of law, and abrogates the state's common law of defamation is to decide whether Rules 14a-7 and 14a-8 are legislative or interpretive rules.[131]

The theoretical difference between the two types of rules depends on whether Congress wishes to equate Commission law making with their own. With respect to legislative rules, Congress recognizes that the agency must make policy which should be respected until Congress decides there is a need for a change. With respect to interpretive rules, Congress has decided the basic policy and has included this policy in the statutory language, with the result that the courts are just as able to interpret the legislation as the agency.

Congress, in enacting Section 14 of the Exchange Act, has made the decision that the Commission is to be the policy making body with respect to proxy rules. Not only does Section 14 of the Exchange Act grant broad rules making powers to the Commission, but Section 14 itself does not become operative until the Commission legislates by rule.[132]

The fact that the proxy rules may be used as the basis to invoke the statutory tort doctrine for private suits indicates they are entitled to the same weight as Congressional legislation. Also, several courts have treated the proxy rules as having the force and effect of law.[133]

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[127] Dyer v. SEC, 287 F.2d 773, 779 (8th Cir. 1961).

[128] *Id.*

[129] *Id.*

[130] 1 Davis, Administrative Law Treatise page 82 (1958).

[131] *Id.* at page 298.

[132] "There are substantive implementing rules which are legislative and not merely interpretive in character. [F]or example . . . Exchange Act provisions on solicitation of proxies were not operative until implemented by Commission rule," Administrative Procedure in Government Agencies, Monograph of the Attorney General's Committee on Administrative Procedure, part 13, Securities and Exchange Commission, S. Doc. No. 10, 77th Cong., 1st Sess. (1941) 101.

[133] *Supra,* note 73.

Legislative rules prescribe what the law shall be, and are entitled to the same force as Congressional legislation if they are: (1) not ultra vires, and (2) are within reason.[134]

A court, in examining a legislative rule, is free to inquire into whether the rule is within the power Congress has delegated to the agency.[135]

The Congressional policy behind the delegation of proxy rule making power to the Commission was aptly stated by the Court in *SEC v. Transamerica Corp.*:

> It was the intent of Congress to require fair opportunity of corporate sufferage. The control of great corporations by a very few persons was the abuse at which Congress struck in enacting 14(a).[136]

The *Transamerica* Court entertained no doubt about the validity of Rule 14a-8.[137]

In enacting Rules 14a-7 and 14a-8 the Commission has attempted to strengthen corporate sufferage by giving security holders a better chance to present their material and proposals to other shareholders. Also, Rules 14a-7 and 14a-8 have an indirect impact on management in that the rules tend to keep management from engaging in questionable practices.[138] The Commission has dealt with the democracy problems by trying to provide an outlet for security holder information which would be the most economical.

If the Commission feels, in order to provide fairness to management, and thus avoid management due process contentions, Rules 14a-7 and 14a-8 should abrogate the state law of defamation. Congress, and not the courts, should be the vehicle to change the Commission's views. Congress, in delegating the proxy rule making power under Section 14 to the Commission, surely delegated the administrative equivalent of the Necessary and Proper Clause. Otherwise, how could the Commission perform its expertise function in the proxy area without having to run the legislative gauntlet for every one of its proxy policies? The courts should not ask, whether the Commission could have instituted their policy through some other means,[139] because this is only

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[134] Dyer v. SEC, *supra,* note 81.

[135] FCC v. RCA Communications, Inc., 346 U.S. 86 (1953).

[136] 163 F.2d 511, 518 (3rd Cir. 1947), *cert. denied,* 332 U.S. 847 (1947).

[137] *Id.* at 518.

[138] 2 Loss, Securities Regulation 910 (2 ed. 1961). Especially in the Rule 14a-8 context, since "effective participation by means of [Rule 14a-7] is only rarely possible because of the large expense," Bayne, Caplin, Emerson and Latcham, Proxy Regulation and the Rule Making Process: The 1954 Amendments, 40 Va. L. Rev. 387, 391 (1954).

[139] Shapiro, The Choice of Rulemaking or Adjudication in the Development of Administrative Policy, 78 Harv. L. Rev. 921 (1965).

for Congress to ask. The court's function is not to determine how well a rule will work, but to decide whether a given solution has any reasoned basis in fact.[140]

The test of whether a legislative rule is ultra vires should be: if there is any cogent reason for the rule (fairness to management in the Rules 14a-7 and 14a-8 no responsibility clauses) in light of the policy maker's philosophy the rule is not ultra vires.

The problem of ultra vires acts has bothered commentators on the FCC's *Port Huron* doctrine.[141] Mr. Justice Frankfurter dissenting in the *Farmer's Union* case felt that in such an important area, as attempting to abrogate state common law, Congress should make the decision. Justice Frankfurter would have left the question of privilege to the states, absent Congressional action.[142] This solution does not lend credence to one important reason for the pre-emption doctrine—that being uniformity. The advocates of the Congress only doctrine would fail to take into consideration that Congress, in its broad grant of power to the Commission under Section 14, has determined that the Commission is to be the policy making organ in the proxy area.

The reluctance of courts to give full credence to agency enacted legislative rules is well illustrated by the New York case of *Major v. Waverly & Ogden.*[143] In the *Major* case, the plaintiff was injured during a fall down a stairway. The defendant failed to provide sufficient lighting or a handrail, which was contrary to a state administrative agency's legislative rule. The plaintiff tried to rely on the statutory tort doctrine, which was an available tort theory in New York, but failed to recover on this theory. The Court held that a violation of an agency rule could not give rise to the statutory tort doctrine, although violation of a legislative statute could invoke the doctrine. The Court went on to say: "a legislative declaration that a rule has the force and effect of law does not make it so, if by that it is meant that it is the equivalent of or equal to a legislative enactment." [144] The only cre-

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[140] "The necessary or appropriate standard in 14(a) lends itself to the interpretation that Congress intended to grant the SEC the broadest of authority in control of proxy solicitation and also, any reasonable regulatory scheme," Caplin, Shareholder Nominations of Directors: A Program for Fair Corporation Suffrage, 39 Va. L. Rev. 141, 154 (1953).

[141] *Supra,* note 116.

[142] However if Congress doesn't like an agency rule it can and does, short of legislative reversal, revoke or modify grants of authority and cut appropriations, Macmahon, Congressional Oversight of Administration: The Power of the Purse, 58 Pol. Sci. A. 161 (1943).

Justice Frankfurter's position, in the Farmers Union Case was, if Congress intended pre-emption they, not the agency, should be the ones to legislate as in Section 312(a) of The Trust Indenture Act. However, Justice Frankfurter admitted that consistent administrative interpretation of pre-emption would have the effect of law if not ultra vires.

[143] 7 N.Y.2d 332, 197 N.Y.S.2d 165, 165 N.E.2d 181 (1960).

[144] *Id.* at 336, 197 N.Y.S.2d at 168-69, 165 N.E.2d at 184.

dence given to the agency rule was that it could be considered as evidence of lack of due care. The court justifies its position by stating that the New York Constitution requires that the Legislature is to be the only body capable of enacting any statute.[145] However, the New York Constitution does not provide that there can be no delegation of binding rule making power. The New York Constitution provides: "The legislative power of this State shall be vested in the Senate and Assembly." [146] The wording of the New York Constitution is similar to the Federal Constitution's declaration of the legislative function, which requires: "All legislative powers . . . [be] vested in a Congress. . . ." [147] Federal delegation has currently not been delimited by this Constitutional wording. The New York position may be explained by the fact that state legislatures tend to delegate to lesser officials without adequate safeguards.

The reason for the New York Court's failure to give credence to agency rules seems to be based on a distrust of agency policy making. States seem to have fallen into the mistaken supposition that since the legislature is elected and primarily responsible to the voters, it should make the laws. The fallacy of this position is that the legislature is still responsible to the electorate, through initiative and referendum procedures, for agency appointments. Also, the agency rule making function is conducted as a miniature democracy in action, especially when public hearings are held. The 'legislature only' theory tends to waste valuable legislative time and not make full use of agency expertise.

If the theory behind SEC proxy Rules 14a-7 and 14a-8 is not ultra vires, the Commission should be able to experiment and implement these rules so as to make them fair to management. This, the Commission has done via of the no responsibility clauses in the two rules.

Due Process

The Commission's no responsibility clauses in Rules 14a-7 and 14a-8, are of course, subject to the same constitutional limitations as any Congressional commerce power legislation. The only constitutional restriction imposed on commerce power legislation is that the legislation must be reasonable; that is, not violative of the Due Process Clause of the Fifth Amendment.[148]

Mr. Justice Stone, speaking for the Supreme Court, in *U. S. v.*

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[145] N. Y. Const. Art. 3, § 1.

[146] *Id.*

[147] U. S. Const. Art. I, § 1.

[148] Boylan v. U.S., 310 F.2d 493, 498 (9th Cir. 1962), *cert. denied*, 372 U.S. 935 (1963).

Carolene Products Co.,[149] has supplied the current principles to be used in determining whether commerce power legislation violates due process.

> [T]he existence of facts supporting . . . legislative judgment is to be presumed, for . . . legislation affecting . . . commercial transactions is not . . . unconstitutional unless in light of the facts . . . it is of such a character as to preclude the assumption that it rests on some rationale basis within the knowledge and experience of the legislators [Commission] . . . .[150] [B]y their . . . nature such inquiries . . . must be restricted to the issue whether any state of facts either known or which could be reasonably assumed afford support for it. . . .[151]

Under this doctrine, no Congressional commerce power legislation, since 1937 has been held to violate due process on the basis of unreasonableness.[152] This test of due process implies (since it is difficult to imagine any legislative rule for which no rational basis may be found) that the due process limitation as to economic matters has been removed. The rational basis for the no responsibility clauses in Rules 14a-7 and 14a-8 is that they are a necessary adjunct to insure fairness to management. If Rules 14a-7 and 14a-8 did not contain the 'no responsibility' clauses, management would have a good argument that the rules violate due process, in that they conflict with the fundamental fairness doctrines.[153]

The plaintiff in a defamation action would not be able to successfully argue that Rules 14a-7 and 14a-8 deprive him of due process since he would still have his defamation action against the security holder.

A United States District Court, in stating that the commerce power is more important than the private individual rights of any one person, held that,

> The plaintiff, in order to sustain a claim of due process as against Commerce Clause legislation, must show a vested right which must be something more than an anticipated continuance of existing law.[154]

An Eighth Circuit decision has provided language which may be used as a summary as to the force and effect of the proxy rules by stating:

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[149] 304 U.S. 144 (1938).

[150] *Id.* at 152.

[151] *Id.* at 154.

[152] See, Light, The Federal Commerce Power, 49 Va. L. Rev. 717 (1963).

[153] "It goes without saying that no court can for a moment entertain the idea that refraining from doing something which the law forbids can constitute fault and create civil liabilities or that a person is a free agent when it comes to a choice between obeying the law and violating it. This is true entirely apart from any question of incurring a penalty. . . ." Felix v. Westinghouse Radio Stations, 89 F.Supp. 740-742 (E.D. Penn. 1950).

[154] Hollingsworth v. Federal Mining & Smelting Co., 74 F.Supp. 1009, 1020 (D.C. Idaho, 1947).

> This grant of legislative . . . power, in its relation to proxy solicitation, requires . . . judicial acceptance of any properly adopted rule . . ., unless it undebatably is unrelated to . . . the policy of the act or unless it is legally unreasonable.[155]

It has been shown that the no responsibility clauses of Rules 14a-7 and 14a-8 are part and parcel of valid legislative rules entitled to the effect of law. These clauses are not ultra vires nor do they violate due process. Therefore, if these clauses conflict with state defamation law, the state law should be pre-empted.

Conflict With State Law

Do the 'no responsibility' clauses of Rules 14a-7 and 14a-8 sufficiently conflict with state defamation laws to justify federal pre-emption?

The answer is found in the *Farmers Union* Case. If the enforcement of a state law would stand "as an obstacle to the accomplishment and execution of the full purposes of the objectives of . . . [the Commission], then the state law is in conflict with federal law and must fall." [156] The majority of the *Farmers Union* Court held that: "Section 315 of the Federal Communications Act, if interpreted to allow the state law of defamation to co-exist with § 315, would be so unfair to stations that unless Congress, by clear expression, called for such a result the Court could not." [157] The same unfairness test applies in the Rules 14a-7 and 14a-8 context, since management does not have the last word on whether to include security holder material in its proxy statement or whether to mail security holder material.

Mr. Justice Frankfurter, dissenting in the *Farmers Union* case, was of the view that Section 315 of the Communications Act did not conflict with state law. He bases his argument on three reasons: (1) the states themselves may invoke state or federal privilege; (2) state libel laws do not prohibit political broadcasts, they just make it less profitable; (3) being fair to the stations is being unfair to the defamed plaintiff.[158] His first reason rejects that uniformity is a desirable object of commerce power legislation; his second reason rejects that there are criminal libel laws; and his third reason rejects that the plaintiff has a cause of action against the original publisher.

Mr. Justice Frankfurter would assume Congress, unless it specifically stated so, would not want to abrogate defamation law.[159] But

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[155] Dyer v. SEC, 266 F.2d 33, 38 (8th Cir. 1959), *cert. denied,* 361 U.S. 835 (1959), *rehearing denied,* 361 U.S. 911 (1959).

[156] *Supra,* note 111 at 535.

[157] *Ibid.*

[158] *Id.* at 535-547.

[159] *Id.* at 541. Coffy v. Midland Broad Co., 8 F.Supp. 889 (W.D. Mo. 1934) said the fact that the station could buy defamation insurance proved that it needed no federal privilege. This contention was dismissed as without merit in Farmers Union.

since the 'no responsibility' language of Rules 14a-7 and 14a-8 have the effect of an act of Congress, his test is satisfied.

An Illustrative Case

The case of *Free v. Bland*[160] can be used as a model of present Supreme Court thinking in the pre-emption field. In this case, the grant of federal power came from the Congressional ability to borrow money on United States credit.[161] Yet the commerce power of Congress may be of a higher priority than the credit borrowing power. The commerce power has been equated with the power of Congress to deal with national security and the national security power has been described as subject to the paramount authority of Congress.[162]

Congress, in the *Free* case authorized the Secretary of the Treasury to issue savings bonds in such form and under such conditions as he may from time to time prescribe.[163] The Secretary's power is very similar to the Commission's proxy power, since the Secretary by rule can create new forms of savings bonds.

The Secretary issued savings bond regulations providing, in part, that such bonds issued to co-owners in the 'or' form would be subject to a federal survivorship provision. The survivorship provision required that the survivor of the co-owners would be recognized as sole owner of the bond.[164]

In *Hilley v. Hilley,*[165] a husband and wife with community funds bought bonds in the 'or' form in Texas, a community property State. The wife died leaving the bonds to her son by will. The husband, relying on the Treasury regulation claimed he was owner of the bonds. The son, relying on Texas community property law, which gives the wife a vested one-half ownership interest in all property purchased with community funds, claimed one half of the bonds under the will. The Texas Supreme Court held with the son's position, stating: "It is clear Federal regulations do not override local laws in matters of private ownership where the interests of the United States are not involved." [166]

The U. S. Supreme Court, invoking federal pre-emption, reversed the Texas Supreme Court and granted sole ownership of the bonds to the husband. The Court held that the Treasury regulations were valid federal law which conflicted with the state law. The Court looked into

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[160] 369 U.S. 663 (1962). It is interesting to note that Mr. Justice Frankfurter did not participate in the Free decision.

[161] U. S. Const. Art. 1, § 8, cl. 2.

[162] Ullman v. U.S., 350 U.S. 422 (1956).

[163] 31 U.S.C. § 757(c) (1958).

[164] 31 C.F.R. § 315.61 (1958).

[165] 161 Tex. 569, 577, 342 S.W.2d 565 (1961).

[166] *Id.* at 570.

the purpose behind the regulation, that of providing a convenient method of making bonds more attractive to purchasers, and held this reason to be determinative of the legal issues since the success of debt management depends, to a large extent, on savings bonds sales. The Supreme Court, in the *Free* case held a determination by a federal agency, under a sweeping grant of power from Congress, that a particular sales gimmick may encourage bond purchases, was not ultra vires.[167] Implicit in the Supreme Court's opinion is the ability of a federal agency to undermine the most sacred of state's rights, those being the powers over forms of property law and wills.

Scope of Federal Pre-Emption

Management, realizing they are operating under the pre-emption doctrine may want to circulate security holder material which they know to be false and defamatory if this procedure will serve their own ends. Should the pre-emption doctrine protect management from liability if such a situation arises? The answer is supplied by the sequel to the *Free* case: *Yiatchos v. Yiatchos*.[168] The husband in *Yiatchos* purchased bonds with community property and became the registered owner. He made a will designating his brothers as the beneficiaries. The Treasury regulation provided that beneficiaries of bonds were to be the sole owners. There was no evidence that the wife consented to this form of bond purchase.

In this case, the U. S. Supreme Court held that if the husband's purchase of the bonds could be deemed to be a fraud on the wife's property rights, the Treasury Regulations would not pre-empt the state property law.[169]

The *Yiatchos* case illustrates that Federal Security Regulations will not allow management to circulate false proxy material to benefit their position. If they try to do so, state defamation laws should apply to them.

Due Process and Defamation

Due, perhaps, to the fact that the state law of defamation has little relation to liability based on fault, the Supreme Court is launching an effort, through the Due Process Clause of the 14th Amendment, to afford defamation defendants more protection from the ravages of state law. The recent case of *New York Times Co. v. Sullivan*[170] illustrates the renaissance in defamation law. In this case, the plaintiff, an Alabama public official, had unquestionably be libeled by an advertisement re-

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[167] 369 U.S. 663 (1962).

[168] 376 U.S. 307 (1964).

[169] *Id.*

[170] 376 U.S. 254 (1964).

published in the New York Times. The plaintiff made no attempt to show actual damage but attempted to use the libel per se doctrine in order to obtain punitive damages. He requested that the Times retract the material but the Times refused his demand on the ground they thought the advertisement did not apply to the plaintiff. Under the Alabama law, in order to justify an award for punitive damages, the plaintiff had to show malice. The Alabama Courts, relying on the doctrine of inferred malice, as opposed to actual malice, awarded the plaintiff $500,000.00.[171]

The United States Supreme Court reversed the decision, holding that the absence of an Alabama defamation defense which would require the public official to plead and prove *actual* malice was a violation of due process. The Court's reasoning was: "there is a . . . national commitment to the principle that debate on public issues should be . . . wide open and . . . may include . . . caustic attacks on . . . public officials." [172] The Court further stated: "The interest of the public . . . outweighs the interest of any other individual." [173]

Although the *Times* case involved a public official there is an analogy from the case to the situation where the person defamed by security holder's Rules 14a-7 and 14a-8 proxy material is a member of management. Members of management have fiduciary duties to the corporation and to the shareholders. Democracy, corporate or political, requires that the voters have access to information concerning their officials. It would be a logical extension of the *Times* doctrine for a court to hold that when a member of management is defamed, through proxy Rules 14a-7 and 14a-8, he takes on the status of a quasi-public official and must prove malice in order to recover damages.[174]

The *Times* case left open the question of whether the public official must prove actual malice if he could establish actual damages as a result of the spoken or written defamatory words. The Court could have gone so far as to extend its doctrine of requiring the defamation plaintiff to prove actual malice on the part of the defendant to the situation where the plaintiff is not a public official. This doctrine, if promulgated in a square holding, would overturn the entire state defamation concept of liability without fault. The Court stated: "What a State may not constitutionally bring about by means of a criminal statute is likewise beyond the reach of its civil law of libel." [175] State criminal libel laws

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171 *Id.*

172 *Id.* at 270.

173 *Id.* at 282.

174 The case of Walker v. Courier-Journal, 246 F.Supp. 231, extends the *Times* doctrine to include the 'public man' as well as the 'public official.' The definition of a 'public man' includes a person of political prominence, who could have reasonably foreseen that his presence would be noticed by news media.

175 *Supra*, note 170, at 277. It is interesting to note the Times Court, at this point in the opinion, cited the Farmers Union case as a footnote to the body of the decision.

require proof of malice. Therefore, lack of actual malice is a required plaintiff's element to be proved in civil defamation. The Court pointed out that civil libel laws may have a more inhibiting effect on speech than criminal libel laws, due to the high damage awards; and the criminal law has certain constitutional safeguards not available to a civil defendant.[176] The wording of the *Times* case may even change the basis of the state law of torts. The *Times* case implies that where the defendant's conduct may invoke both criminal and civil liability (especially if the conduct may be the basis of high civil damages and pertains to areas in which there are constitutional guarantees) the elements of the tort must be the same as those of the crime. The Court is worried about the possibility of states using the civil law in an attempt to be rid of recently promulgated criminal procedural due process requirements.

Survey of State Law of Defamation

Republication Doctrine—The majority of states follow the rule that "every publication or republication of defamatory material is a separate tort for which the republisher is liable . . . ." [177]

The republisher's tort liability is based on the premise that the risk of harm to reputation and society is especially great in defamation.[178] Thus, it is of no avail for republishers, except secondary disseminators such as news vendors, bookstores or libraries,[179] to allege that they could not, assuming they used due care, have located or recognized the defamatory words. The strict liability rule is relaxed in the case of secondary disseminators because they have no real opportunity to examine the vast amount of printed matter they deal with. In the telegraph situation, a Federal Circuit Court has held that Congress has pre-empted the state law of defamation which imposed the strict liability basis.[180] Prior to the *Farmers Union* case the states were split as to whether the Federal Communications Act provided a state privilege to radio and television stations. In fact, some state statutes which gave

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[176] *Ibid.*

[177] Heller v. Bianco, 111 Co. App.2d 424, 244 P.2d 757 (1952). 1 Harper & James, the Law of Torts § 518, p. 402 (1956).
See, Painter, Republication Problems in the Law of Defamation, 47 Va. L. Rev. 1131 (1961).

[178] Lubore v. Pittsburgh Courier Co., 200 F.2d 355 (D.C. Cir. 1952).

[179] Ayako Sakam v. Zellerbach Paper, 25 Cal. App.2d 309, 77 P.2d 313 (1938).

[180] The telegraph situation was another instance where, before federal pre-emption was invoked, the states were split as to whether the telegraph companies had any privilege for defamatory sender material. No privilege, Peterson v. Western Union Tel. Co., 65 Minn. 18, 67 N.W. 646 (1896); qualified privilege, see, Grisham v. Western Union Tel. Co., 238 Mo. 480, 142 S.W. 271 (1911). Based on unfairness and a federal statute which made telegraph companies common carriers a Federal Court invoked the penumbra doctrine and gave telegraph companies a federal privilege, O'Brian v. Western Union Telegraph Co., 113 F.2d 539 (1st Cir. 1940).

radio stations immunity were struck down in state courts as violative of the state and federal equal protection clauses.[181]

State Qualified Privileges—In addition to truth and several absolute privileges,[182] not important in the proxy context, there are recognized state qualified privileges which may give management some protection if federal pre-emption is not invoked. All qualified privileges require that the defendant prove absence of malice as a condition to their use.[183]

The theory in support of the use of a qualified privilege is that when the social advantage of the defendant's words tend to outweigh the harm to the plaintiff, the defendant should be granted a privilege, unless he acts without the public interest in mind.[184]

Some states have adopted a qualified privilege referring to the interests of a third person or the public.[185] Under this privilege, communications from one shareholder to another[186] or from the corporation to the shareholders[187] relating to business matters have been held qualifiedly privileged. The difficulties with this privilege are, that not all states allow the privilege and the communications must relate to some aspect of the plaintiff's business conduct.[188]

If the defamed plaintiff is a member of management, a person whose performance is held up to shareholder approval, the qualified privilege of 'fair comment' [189] may be available to the corporation and other members of management for defamatory words circulated through Rules 14a-7 and 14a-8.

This privilege only protects against false statements of opinion.[190] This distinction between opinion and fact involves courts in unreasonable distinctions between fact and opinion and opinion based on fact, and involves variations too fine for the human mind to comprehend. Further, this privilege does not extend to situations where the defamation unreasonably concerns the plaintiff's private life.[191]

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181 Because the privilege was not accorded to other news media such as newspapers, Werner v. So. Calif. Ass'n. of Newspapers, 35 Cal.2d 121, 216 P.2d 825 (1950).

182 For defamatory words spoken in judicial, legislative and administrative proceedings. This absolute privilege in administrative proceedings protects management from liability when the SEC reviews management proxy statements under Rule 14a-6, which contains security holder Rule 14a-8 proxy material. See 1 Harper & James, the Law of Torts §§ 5.22, 5.23, 5.24 (1956).

183 *Id.*, Harper & James at §§ 5.25, 5.27.

184 *Id.* at § 5.25.

185 3 Restatement, Torts § 596.

186 Baker v. Clark, 186 Ky. 816, 218 S.W. 280 (1920).

187 Garey v. Jackson, 197 Mo. App. 217, 193 S.W. 920 (1917).

188 Odgers, Slander and Libel, 231 (6th ed. 1929).

189 *Supra,* note 185, § 606.

190 Nevada State Journal Pub. Co. v. Henderson, 294 F. 60 (9th Cir. 1920).

191 *Supra,* note 189.

The evils connected with the reliance on state privileges are: (1) lack of uniformity among the states as to whether a privilege exists; (2) suppression of SEC ability to determine whether Rules 14a-7 and 14a-8, in fact, promote 'shareholder democracy'; and (3) a basic unfairness to management which may violate its due process guarantees.

Conclusion

Invoking federal pre-emption to abrogate the state law of defamation, in the context of Rules 14a-7 and 14a-8, may be a Pyrrhic victory for protagonists of a centralized power structure.

The Commission could have solved the problem of inter-shareholder communications by requiring the corporation to pay for distribution of security holder proxy material and proposals. This solution would not raise any defamation issues since management would not be required to republish security holder material. But, the Commission's present method of dealing with a problem involving national policies should not be abandoned because the solution, as to which segment of the economic community will bear the risk of unfairness, inherent in Rules 14a-7 and 14a-8, fails to favor a state protected tort right rather than a regulated enterprise.

The Commission, even though pre-emption is available, should not abandon their rigorous fraud policing under Rule 14a-9. Commission review of proxy material, under Rule 14a-9, is undoubtedly the reason Rules 14a-7 and 14a-8 have never been involved in a state defamation action. Pre-emption should be saved for the situations where the Commission feels the security holder's information is of enough value to be circulated to fellow shareholders even if the information is of questionable truth, and to the instance where neither the Commission nor management recognizes any wording as being defamatory.